ABN·AMRO

Housing Market Monitor

Group Economics

Netherlands

6 July 2017

Housing market temperature soars

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- **We have raised our transaction and price forecasts**
- **House sales are benefiting from low interest rates and economic revival**
- **Housing scarcity is driving prices ever higher**

The temperature will continue to soar in the housing market this summer. Driven by the economic recovery and low interest rates, sales hit an annualised record of 232,000 in May. Taking their cue from the large cities in the Randstad conurbation, other regions are now also moving into a higher gear. Some cities are already showing signs of overheating, with bids above the asking price no longer an exception. The average house price in the Netherlands posted a year-on-year increase of nearly 8% in May. If it continues rising at this rate, the peak of 2008 will soon be reached. The current average price is only 7.5% below that level. Scarcity is an important reason for the sharp price spike. During the crisis, new-build activity suffered a severe slump. Although construction is picking up, the number of house completions is still not keeping pace with the growing number of households, nor is this likely to happen any time soon. The persistent low mortgage rates are also fuelling prices. Earlier, we assumed that interest rates would edge higher in the course of the year. We still believe that they will, but now foresee a less powerful increase than previously thought. The strong results for the first five months combined with the lower interest rate outlook have prompted us to raise our price and transaction forecasts for 2017 and 2018.

Price and transaction forecasts

	Transactions (% y-o-y)	Prices (% y-o-y)
2016	20.5	5.1
2017	15 (5)	7 (5)
2018	-5	5 (3)

Source: Group Economics — Old estimates in brackets

Further increase in transaction volume

Sales of existing housing will continue to rise this year. According to Land Registry data, 232,000 existing properties were sold in the 12 months until end of May, a fifth more than in May 2016. The continuing strong rise suggests that sales will set a new record this year.

The transaction boom is broad-based and gradually fanning out across the country. The provinces that initially lagged behind have taken over the baton from the original front-runners (Noord-Holland, Utrecht and Groningen), where sales are now growing at a more moderate pace.

House sales show broadening recovery

Annual transaction volume by region

Source: Land Registry

One key reason is the reduced supply, which is making it harder for buyers to find a suitable home. According to home search website *huizenzoeker.nl*, there were 105,000 existing properties for sale in May, 41,000 less than a year ago.

The shrinkage in supply is particularly rapid in the large cities. In May, fewer than 4,000 properties were on the market in Amsterdam, The Hague, Rotterdam and Utrecht versus 11,000 one year ago. Apart from the surge in sales, this is also due to the fact that sellers are delaying putting their home on the market in order to prevent being left without a house. And they also hope to benefit from further price increases by waiting a little longer.

Houses are changing hands faster. Properties sold in the first quarter of this year were on the market for an average of 77 days, according to the Dutch Association of Real Estate Brokers (NVM). That is a month shorter than a year earlier. Thanks to the recovery, there are fewer slow-selling properties. Calcasa has said that the share of properties that have been on the market for more than two years is now only 10% versus 17% a year ago.

In this tightening market, buyers must decide faster to clinch a deal. More and more buyers are therefore making bids without adding a mortgage or home inspection contingency to the contract. A survey among NVM estate agents shows that this concerned 12% and 57% of the transactions in the second half of last year respectively.

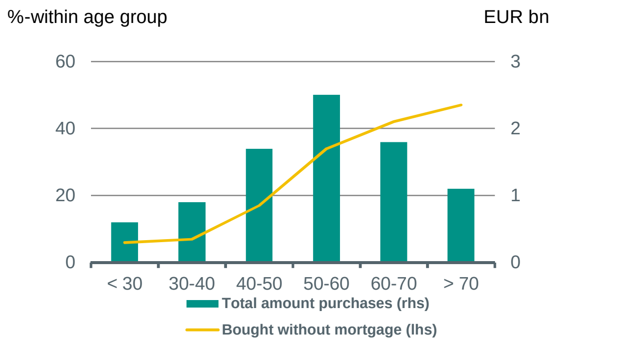
This can be a high-risk strategy, however. Structural defects that come to light later can be costly. Moreover, buyers who back out of the contract risk a penalty of 10% of the purchase sum or higher. In short, unless buyers have the expertise to inspect the property themselves or can self-finance at least part of the property, waiving the inspection and/or mortgage contingency can cause serious problems. A study is now under way to assess the extent to which these practices occur. Depending on the outcomes, the cabinet will decide whether measures are required.

The urgency to buy is also being reinforced by the increased activity of private investors. They can self-finance at least part of the purchase, which makes them less dependent on mortgage finance and able to act more quickly. According to the NVM, the share of private landlords in house sales has doubled to 6% in the past ten years. Investors are mainly interested in properties in popular cities, where rental yields are high, particularly compared to the current savings rates.

The increased investor interest is one reason why the number of properties being purchased without a mortgage is on the rise. The Dutch Central Bank (DNB) estimates this share at 16%, which is twice as high as in 2008. Another reason for the increase in sales without a mortgage is the expanded gift tax exemption. DNB sees a link between parental gifts and the larger down payments made by first-time buyers.

The increased investor interest is one reason why the number of properties being purchased without a mortgage is on the rise. Land Registry data suggest that 17% op purchases was financed without mortgage, 6 percentage points higher than in 2006. In total these purchases amounted to EUR 8.6 bn, of which investors put in EUR 3.5 bn, similar to home movers. First time buyers were responsible for EUR 1 bn and foreign buyers for EUR 0.5 bn. The Dutch central bank sees a relation between donations of parents induced by the tax exemption on donations and the rise in contributions by first time buyers.

Primarily elderly households buy without mortgage



Bron: Kadaster

With most transactions, the sellers meet their legal obligation to provide an energy label. According to the Ministry of the Interior, 87% of the transactions were compliant with the energy label requirement last year. That is an improvement of 10 percentage points compared to the previous year. Sellers who fail to meet this requirement receive a letter from the Human Environment and Transport Inspectorate notifying them of this obligation and explaining how to register an energy label. If the seller does not respond to the letter, the inspector can impose a penalty of EUR 405.

Upward price momentum is gathering pace

The tight housing supply puts sellers in a strong bargaining position. There is much less pressure to lower the asking price. Four out of five properties are sold at or above the asking price, according to NVM data. At the low point of the crisis, the price of half of the sold properties was reduced at least once during the selling process.

The tables are now turned and many sellers are actually raising their asking price. The average asking price is currently EUR 331,000, 7.6% higher than a year ago. The shift in the balance of power towards the seller is also evident in the narrowing gap between the asking and selling price. According to the NVM, the difference is now only 2.2%, whereas the historical average is 3.9%.

Transaction prices are climbing rapidly at the moment. In May, the Land Registry price index was no less than 7.8% higher than a year ago. It is a long time since property values have made such strong gains; this was in 2002 to be exact. But inflation was significantly higher then, so real term prices are rising faster now. If prices maintain this upward momentum, the pre-crisis peak will soon be in sight. Current prices are only 7.5% below the 2008 level.

Values rapidly closing in on 2008 price peak

Source: Land Registry

But there are clear differences between the regions. The smaller the stock of properties for sale relative to the number of transactions, the stronger the price increase. This is eminently visible in the Randstad conurbation, where the housing market is showing signs of overheating. Buyers in the large cities regularly overbid the asking price, so that a relatively large number of homes are sold above the asking price. And due to the lack of suitable properties in the cities themselves, more and more buyers are turning to surrounding areas, which is also pushing up prices there.

Differences can also be seen between the diverse types of housing. According to Calcasa, houses in price segments above EUR 250,000 appreciated by 8% or more in the first quarter, while housing in the lower segments rose ‘only’ 7%. The difference is probably due to the growing share of home movers in the housing market. In 2016, they accounted for 65% of the market, 10 percentage points higher than in 2013 when the number of sales was at rock bottom.

Finally, apartments are in greater demand than corner and terraced houses. And these, in turn, are rising faster in value than detached properties. In addition, pre-war housing is more popular than post-war housing. Housing from the 1980s and 1990s attracts the fewest buyers, relatively speaking. These differences are partly related to the increased preference for urban living, preferably in or near the city centre. Old houses and apartments tend to be more prevalent in these neighbourhoods.

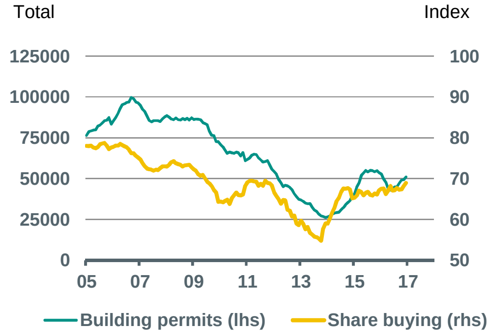
New-build activity is lagging demand

The housing market recovery is less prominent with new-builds. In the 12 months until the end of April, 33,000 new owner-occupied properties were sold. That is just under 3% more than in the same month one year ago.

However, the prices of sold new-builds are rising fast. According to the NVM, the median selling price rose last year by 12% to EUR 297,000 in the first quarter. In other words, the increase is higher than for existing homes, which is partly because the composition of the sold houses is changing. During the crisis, a relatively large number of small cheap houses were built for first-time buyers. Now, project developers are focusing more on larger houses for people moving up the property ladder. Even so, project developers say that the share of expensive new-builds is still only 30%, 10 percentage points below the pre-crisis level.

The reason for the lagging new-build sales is not lack of demand, but lack of supply. Buyers are increasingly registering their interest with project developers, but construction continues to undershoot demand. According to the NVM, buyers could still choose from 10 new-builds in 2012 as opposed to only 2.5 at the end of 2016.

Issued building permits lagging behind



Source: **Statistics Netherlands (CBS)**

The shortfall is largely related to the shortage of suitable sites for residential construction, partly because of the focus on building in city centres. In addition, the spatial planning process is extremely complicated. Finally, local authorities and developers have insufficient capacity to develop building projects. During the crisis, when construction ground to a halt, they laid off too many staff to cut costs. However, this problem seems to have been solved by now.

The complexities of the decision-making around spatial planning are more difficult to overcome, however; particularly as new-build construction must also comply with the ambitious energy transition, sustainable building and circular economy goals. In a recent report, the Council for the Environment and Infrastructure set out solutions for improving the policy instruments. But it will take time for the proposed measures to be implemented and become effective.

The current focus on inner-city construction will become less stringent from 1 July. The requirements of the 'Sustainable Urbanisation Ladder', which is designed to ensure careful and transparent spatial planning decisions, will be relaxed. But whether this adjustment will help to reignite the production of housing to a sufficient extent remains to be seen. Less emphasis on inner-city construction would certainly help. But more changes are probably necessary to meet the daunting challenge facing the Netherlands: about 80,000 homes need to be completed every year, 30,000 more than the average number of homes added in the past five years.

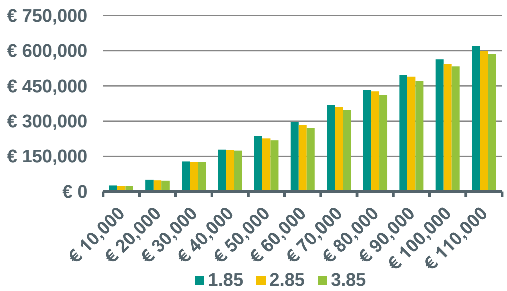
Price increases driven by persistently low interest rates

The scarcity of housing is far from being resolved. The ongoing shortfall of new-builds will drive prices even higher. Another factor that has a strong effect on prices is the mortgage income criteria that determine how much buyers can borrow based on their income and interest rates.

In recent years, the percentage of the partner's income that can be included for mortgage calculation purposes has steadily increased. This percentage is currently 60% as opposed to 50% last year and 33% in earlier years. At the current 10-year mortgage rate of 2.85%, a double-income household with each partner earning EUR 50,000 can now jointly borrow EUR 534,000. That is EUR 10,000 more than with the inclusion of 50% of a second income and EUR 30,000 more than with the inclusion of 33%. The relaxation, which will continue in the coming years, has a strong impact on the buyer's borrowing capacity and therefore on prices as well.

Interest rate strong determinant of mortgage amount

Maximum amount by income of single-earner family with various interest rates



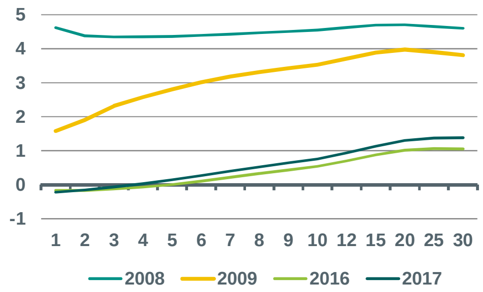
Source: Nibud (National Institute for Family Finance Information)

The low mortgage rates stem partly from the accommodating monetary policy of the European Central Bank (ECB). In recent years, the ECB has slashed its official rates while also buying up bonds and other debt securities on a large scale. Swap rates – a good barometer for the financing costs of banks – have thus been pushed sharply lower. In line with lower financing costs, mortgage rates have also declined. In April, the 10-year mortgage rate was 2.85%, twice a low as in 2008.

The swap rate has recently crept fractionally higher, probably because the Fed is gradually normalising its policy and more and more investors are expecting the ECB to follow suit in due course. We anticipate that the ECB will start reducing its monthly bond-buying programme from January next year and will then raise its official interest rates at the end of the year. If this scenario materialises, mortgage rates will probably also go up.

Slight increase in swap rate points to higher mortgage

Interest percentage by fixed-rate term



Source: Reuters Thomson Datastream

The recent increase in the swap rate has had little effect on mortgage rates so far. More intensive competition in the mortgage market is preventing mortgage lenders from upping their rates. Instead, they are making do with tighter margins. But whether they will keep this up in the longer term, when swap rates rise, is a matter of conjecture. Also, pension funds and insurers may lose interest in mortgages if the economic recovery continues and other investments become more lucrative. A sustained economic revival could thus herald less intensive competition.

However, even if mortgage rates rise, this need not pose an immediate problem for most home-owners. The preference for long fixed-rate periods has increased markedly in recent years. So it could take a while before borrowers are confronted with higher monthly charges. Added to this, the income criteria of the National Institute for Family Finance Information (Nibud) contain a built-in buffer to ensure households can absorb an increase in their monthly expenses due to rising interest rates. Finally, the anticipated rise in income will also offer a degree of protection.

The first to feel any pain from higher interest rates will probably be the buyers of the future. The loan-to-income amount they can borrow will be lower, which will make it harder for them to secure a suitable property, particularly at today's elevated prices.

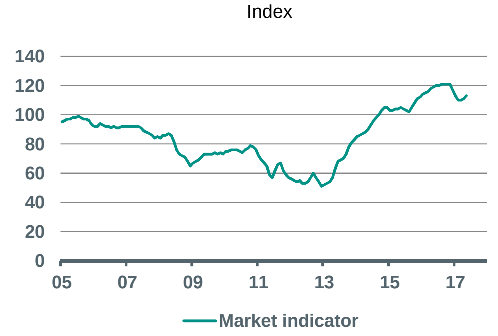
Confidence indicator rises again

Low interest rates are keeping the housing market affordable. Net housing expenses excluding repayments account for an increasingly smaller portion of net income. In the first quarter of 2017, this percentage was just 14%, twice as low as at year-end 2008.

Improved affordability is bolstering confidence. In November, the Market Indicator of the Dutch Home-owners' Association hit a record high at 121, but then lost ground, partly due to a growing awareness that mortgage rates might rise. In addition, lack of supply also dampened the enthusiasm about the housing market.

In recent months, however, the sentiment indicator has resumed the upward trend, rising from 110 in March to 113 in May – probably because mortgage rates appear to be stable at the current low levels. The economy's better-than-expected performance is also boosting sentiment. GDP is set to grow 2.5% this year, the highest level in 10 years' time. In addition, employment growth and higher wages are driving up disposable incomes. This, too, is injecting fresh optimism into the housing market.

Confidence in housing market resumes upward trend



Source: Dutch Home-owners' Association

But not everyone is equally upbeat. Confidence is higher among high-income households than low-income households, one reason being that, on balance, the income criteria have tightened more for low-income groups in recent years.

In addition, first-time buyers are less optimistic than home movers. In accordance with this shift, the share of home movers in the transaction volume is steadily growing. This is reflected in the distribution of sales across various price segments. The low price segment, in which first-time buyers tend to be active, represents a steadily decreasing share of sales.

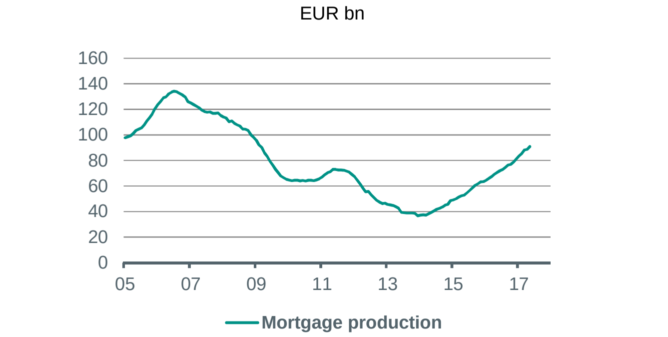
There are various reasons for the different levels of optimism. The current obligation to make a down-payment is more onerous for first-time buyers (who have had less time to save) than for home movers. Added to this, home movers can now sell their home more easily and – thanks to the price recovery and extra voluntary repayments in the past years – fewer are saddled with negative equity. Since 2013, households have made extra repayments to the tune of EUR 55 billion.

New mortgage business accelerates

In line with the housing market recovery, new mortgage business is also moving up a gear. According to the Land Registry, a quarter more mortgages were taken out in the 12 months until May than a year ago. The average mortgage sum was also 7.4% higher at EUR 281,000. As a result, total new mortgage business came to EUR 91 billion, EUR 21 billion less than in the same month a year ago.

At the same time, the volume of repayments is rising. Apart from the extra repayments, the increase is also due to the obligatory annuity payments. This explains why the outstanding mortgage volume is rising significantly less quickly. Based on Statistics Netherlands (CBS) data, the outstanding mortgage amount in the first quarter of 2017 was EUR 667 billion, EUR 7.5 billion more than a year ago.

Strong increase in new mortgage business



Source: Land Registry

According to the most recent DNB data, banks are relaxing their acceptance criteria. Lending risks are diminishing because the labour market is picking up. Thanks to growing employment and rising disposable incomes, the number of home-owners with payment arrears is falling. Figures of the Dutch Credit Registration Office (BKR) indicate that 98,000 households have mortgage arrears versus 110,000 a year ago.

The risk of negative equity is also receding. This is visible in the claims submitted to the Dutch Home-ownership Guarantee Fund (WEW). In the first quarter, 651 WEW claims were submitted, nearly a third less than in the same quarter last year. The amount involved was EUR 14.8 billion, less than half of what was claimed in the first quarter of 2016.

Nevertheless, many home-owners still have a higher mortgage than the value of their home. This mainly concerns home-owners in the more peripheral areas who bought their home in the years preceding the crisis. The most recent DNB calculations show that this problem affects 17.5% of mortgage borrowers, or 600,000 households.

Until the end of this year, the interest that people are charged on negative equity after moving house is eligible for tax relief during a 15-year period. After 1 January 2018, moving house with negative equity will be financially less attractive. Apart from the loss of tax relief, lenders will treat negative equity as consumer credit, which attracts a higher interest rate than mortgages.

Most at risk among home-owners with potential negative equity are those with an interest-only mortgage. According to the Ministry of the Interior, this concerns a relatively small group of around 40,000 households. Mortgage lenders are now trying to contact this group in order to jointly explore ways of repaying this debt and mitigating the financial risks. They will then broaden their scope to other households with interest-only mortgages.

Over one-third of the 3.5 million households with a mortgage have an (nearly) fully interest-only mortgage. Fortunately, many of these households bought their property long ago and have substantial home equity, so the risk of negative equity is limited. Nevertheless, payment problems may still arise when their income falls on retirement or when their interest charges rise due to the loss of mortgage relief after the maximum thirty-year term.

More resources for improvement of the housing stock

A study performed by Platform 31 in 2013 of problems at the lower end of the private housing market showed that 600,000 homes are in relatively poor or poor condition and/or have a poor energy performance. Investments equal to at least 10% of the new-build value are necessary to bring these properties up to present-day standards.

A lack of funds is often the reason why home-owners fail to carry out maintenance or make their property more sustainable. Numerous subsidies are available, but these are not always known. Moreover, experience shows that subsidies are often withdrawn after a short period of time. Sometimes home-owners opt not to apply because they think they might be too late anyway.

Dependence on uncooperative neighbours can also impede necessary maintenance. This is a particular problem with home-owners' associations, as residents who want to move see no point in making long-term investments in maintenance and improvements. On 23 May. the Senate passed a bill obliging home-owners associations to annually set aside at least 0.5% of the reconstruction value of the apartment building or an amount based on a sound long-term maintenance plan. Under this proposal, which will take effect in January 2018, they can in future also enter into loans to cover unforeseen costs and make investments in energy-saving measures.

Finally, a lack of knowledge of the various options and the potential financial benefits can act as a barrier. Many home-owners do not have the information they need to make a well-considered decision. The range of available home improvement measures and materials is staggering. Moreover, a long chain of wholesalers and engineering firms lies between the home-owner and manufacturer. This, too, impedes the exchange of knowledge.

The 'Renovatiesprong' programme has been launched to remove these obstacles. The programme is aimed at certain common types of housing, notably post-war blocks of flats and terraced housing built between the 1950s and late 1980s. The first municipalities to launch this programme are Apeldoorn, The Hague and Rotterdam.

In the first instance, ambassadors will seek to raise awareness of the need for renovations among home-owners. Using an app that is suitable for laptops, PCs or tablets, interested residents will receive assistance in assessing what measures are feasible based on their energy consumption and family circumstances. They are also given an indication of the costs of the measures. Any measures that are to be financed collectively will be integrated into the home-owners' association's maintenance plan. Next, the so called *system integrator* is called into action. This person selects the measures that best suit the individual households or home-owners' association and recommends reliable engineering firms. The measures are then implemented based on the choices of the resident or home-owner's association.

Not much news on the housing policy front

What the future government has in store for the housing market remains to be seen. Efforts to form a new government have been unsuccessful so far. One theme that the next government will need to address is the maximum loan-to-value amount that households can borrow. Various parties such as the IMF and DNB want to see a gradual decrease in the loan-to-value ratio to 90%, so that the risk of negative equity is reduced. But there are several disadvantages to this proposal. For one thing, a recent study of the CPB Netherlands Bureau for Economic Policy Analysis shows that households would have to wait 18 months to three years longer on average before they could afford the home they want.

Although the caretaker government has put important decisions on hold, it has decided to reverse one measure that was announced for Budget Day. Owners of listed buildings will be allowed to continue deducting 80% of their maintenance costs from tax. The government has set stringent demands regarding the maintenance and upkeep of listed buildings. So it makes sense to help owners meet these costs. Now that the cabinet has abandoned its intention to withdraw this tax relief, owners of listed buildings no longer need to fear a substantial increase in their housing expenses.

Another recent subject of political debate was the Hillen Act. Home-owners with a low mortgage debt benefit from this law, which stipulates that taxed imputed rental income is not exceed to the received mortgage interest relief. However, since 2013, the highest tax rate at which home-owners can deduct mortgage interest has been reduced annually by 0.5%. As a result, in some cases the scheme no longer offers any benefit to the taxpayer. When the government introduced this tax change, then Housing Minister Stef Blok said that people could get round this drawback by not declaring the interest paid in their tax return. But the current State Secretary for Finance Eric Wiebes has issued a statement forbidding this loophole.

Finally, the cabinet is looking into whether lenders need to be issued with uniform rules for calculating the costs of interest rate averaging. Finance Minister Jeroen Dijsselbloem is of the opinion that the charged costs should not exceed the financial disadvantage that the lender sustains, just as with early repayments.

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